STATE OF ARIZONA

CITIZENS CLEAN ELECTIONS COMMISSION

MUR: No. 06-0001

STATEMENT OF REASONS OF EXECUTIVE DIRECTOR

On behalf of the Citizens Clean Elections Commission (the "Commission"), the Executive Director hereby provides the Statement of Reasons for the recommendation that the Commission find reason to believe that violations of the Citizens Clean Elections Act and Commission rules (collectively, the "Act") occurred.

I. Procedural Background

On April 26, 2006, Glenn Hamer (the "Complainant"), Executive Director of the Arizona Republican Party, filed a complaint (the "Complaint"), together with supporting documentation, against Janet Napolitano (the "Respondent"), a participating candidate for governor, alleging possible violations of Arizona election law. Exhibit A. On May 4, 2006, Respondent's counsel filed a reply (the "Reply"), together with supporting documentation, responding to the matters described in the Complaint. Exhibit B.

II. Factual Background

The Executive Director finds the following facts are supported by the Complaint, the Reply and the supporting documentation and information provided by the Respondent.

On March 1, 2006, Respondent filed a statement of organization registering her campaign committee, Janet Napolitano 2006 (the "Committee"), with the Secretary of State. On the same day, Respondent launched a campaign website (http://www.janet2006.com) (the "Website"). On that day Respondent also filed with the Secretary of State an application for certification as a participating candidate. The Commission certified Respondent as a participating candidate on that same date.

On or about March 9, 2006, and again on or about April 13, 2006, the Vendor sent mass email messages regarding Respondent's campaign and the collection and filing of five-dollar qualifying contributions. Upon information and belief, other email solicitations were sent out by Vendor on behalf of Respondent between March 1, 2006 and March 15, 2006.

On March 15, 2006, the Committee entered into a Letter of Agreement for Internet Consulting and Related Services (the "Agreement") with Integrated Web Strategy, LLC (the "Vendor"). Exhibit C. The Agreement stipulated that Vendor would

develop and maintain the Website, develop and implement a strategic email plan, lease email lists for use by Respondent's campaign (including those sent out prior to March 15, 2006) and provide certain other services. In consideration for the Website and services, the Committee agreed to pay Vendor a total of Twenty-Seven Thousand Five Hundred and 00/100 Dollars ($27,500.00) in nine monthly installments of Three Thousand Fifty-Five and 55/100 Dollars ($3,055.55), with the first installment due on March 21, 2006. The Agreement also included an early termination clause that guaranteed Vendor would receive 75% of the total value of the Agreement. Respondent received public funding as a participating candidate on April 24, 2006.

III. Issues Raised in Reply

A. Respondent's Procedural Argument

In her Reply, Respondent argues that the Commission lacks jurisdiction to consider the matters described in the Complaint. The Executive Director recognizes that violations of A.R.S. Title 16, Chapter 6, Article 1 are within the jurisdiction of the Secretary of State. See A.R.S. §§ 16-916(A)(1) (Secretary of State is filing officer for political committees supporting candidates for state offices) and 16-924(A) (filing officer responsible for determination whether there is reasonable cause to believe that a person is violating any provision of A.R.S. Title 16, Chapter 6, Article 1).

Notwithstanding such provisions, the Commission is charged in A.R.S. § 16-956(A)(7) to "[e]nforce the provisions of [A.R.S. Title 16, Chapter 6, Article 2]." With respect to violations of the Act, the Executive Director finds no merit in Respondent's argument that the Commission lacks jurisdiction. Allegations regarding Article 1 violations will be referred to the Office of the Secretary of State.

B. Respondent's Arguments on the Merits

1. Arguments re Contributions and/or Expenditures Prior to Registration of the Committee

A political committee that intends to accept contributions or make expenditures of more than Five Hundred and 00/100 Dollars ($500.00) is required to file a statement of organization with the Secretary of State before accepting contributions or making expenditures, among other activities. A.R.S. § 16-902.01(A). On March 1, 2006, Respondent filed a statement of organization registering the Committee with the Secretary of State. On the same day, Respondent launched the Website.

In her Reply, Respondent interprets the Complaint as alleging that Respondent's receipt of the Website and other services evidenced an "expenditure" as defined in A.R.S. § 16-901(8), which expenditure, if made before the registration of the Committee, would violate A.R.S. § 16-902.01(A).[1] Respondent then argues that no expenditure occurred

[1] Any alleged violation of Article 1 in this matter would likely implicate A.R.S. Section 16-903 as well, and will be referred accordingly.

until March 21, 2006, the due date for the first installment payable under the Agreement, and that Respondent therefore did not violate A.R.S. § 16-902.01(A).

The discrete question of whether Respondent violated A.R.S. § 16-902.01(A) and/or A.R.S. § 16-903(A) (as opposed to questions related to A.R.S. Title 16, Chapter 6, Article 2) is properly considered by the Secretary of State rather than the Commission. See A.R.S. §§ 16-916(A)(1) and 16-924(A). The Executive Director therefore recommends that the issues be referred to the Secretary of State for further consideration.

2. Discussion as to whether an "expenditure" occurred.

For purposes of the Act, the term "expenditures" has the meaning given in A.R.S. § 16-901(8). A.R.S. § 16-961(A). A.R.S. § 16-901(8) defines "expenditures" broadly to include any:

> purchase, payment, distribution, loan, advance… or anything of value made by a person for the purpose of influencing an election…and a contract, promise or agreement to make an expenditure resulting in the extension of credit and the value of any in-kind contribution received.

The requirement that the full amount of a payment obligation is to be reported as an expenditure as soon as the payment obligation is incurred is consistent with the purpose of Article 1 of Title 16, which is to provide information to the public regarding a candidate's contributors and spending choices and timing.

Respondent acknowledges that she received the benefit of a working website on March 1, 2006 and in fact had contractual obligations to the vendor to pay for that benefit. Yet Respondent asserts that these circumstances do not constitute an "expenditure" in violation of the Act. Respondent argues that the subsequent Agreement of March 15, 2006 included an extension of credit, and only then was there an expenditure.

Respondent's reasoning is unpersuasive and if adopted, would create an unworkable reporting system. The Act places significant financial restrictions on participating candidates. They are permitted to spend only the public funds provided to participating candidates (and any matching funds that may be triggered), and very limited early contribution monies and personal monies. If permitted to accept large benefits up front and then to contract for them later, candidates could effectively avoid these restrictions and spend money they do not yet have. Vendors may be willing to provide this service to established candidates, but this practice does not comport with the restrictions on participating candidates.

Moreover, Respondent's interpretation of the term "expenditure" undermines the reporting requirements of Title 16, Article 1. By artfully writing contracts, candidates could commit large sums of campaign funds and receive significant benefits (such as campaign signs, a website, or the like), but not report them on the campaign finance

reports until some convenient time later when the contract is put in writing and a convenient date for payment is set. The voters and opposing candidates would not have an accurate picture of how money is spent until some time down the road, if ever.

As noted in training materials cited by the Respondent, "expenditures" include debt, and debt is created when the promise to pay arises. Respondent acknowledges she incurred an obligation to pay when she accepted the Website and authorized other services to be performed on her behalf on March 1, 2006. For these reasons, I believe that an expenditure of some value occurred on March 1, 2006 when Respondent's website went online as a live, publicly accessible site.[2] Commission Rule R2-20-104(D)(6) prohibits participating candidates from incurring debt greater than cash on hand. Whether a violation occurred depends on the value of the services provided and whether Respondent had enough money on hand to pay for those services.

3. Arguments re Cost of Services Under Agreement as Regularly Recurring Administrative Expense

Respondent relies on a limited "recurring expenditures" exception to the general rule that "debt is incurred when the benefit is received or the promise to pay is made." This provision is articulated at Page 59 of the *Citizens Clean Elections Commission 2005-2006 Participating Candidate Guide*, which states that "[r]egularly recurring administrative expenses such as rent, utilities and salaries are NOT considered to be debts until the payments are past due." Page 61 instructs: "[r]ecurring services such as telephone service, cell phone service, utility service and rent, become reportable expenditures the date that the campaign…receives the bill."

In her Reply, Respondent denies an expenditure occurred before March 15, 2006 but argues that even if the Commission finds otherwise, the payment obligations under the Agreement constitute "regularly recurring administrative expenses," akin to rent, utilities and salaries. This exception, even if it applies to the March 15, 2006 Agreement, cannot apply to the expenditures prior to March 15, as there was no contract in existence that provided for recurring payments. But a discussion of the exception is worthwhile.

While the Commission has recognized rent, utilities and salaries as regularly recurring administrative expenses and exceptions from the prohibition on debt, this exception is not expansive. It is designed to cover routine expenses not specifically or directly associated with the production of identifiable goods and services, especially when the value of such goods and services can be difficult to quantify in advance. The Arizona Supreme Court distinguished ordinary expenses as periodical and *recurrent* expenses, as opposed to extraordinary and infrequent expenses. Tax Commission v. Kieckhefer, 67 Ariz. 102, 106 (1948).

[2] Respondent correctly points out that vendors routinely provide campaign materials for review prior to creating an obligation to pay. But the website at issue here is not the equivalent of a draft campaign brochure or the like. It is a finished product in that it was made active and available to the public. Moreover, it successfully brought in thousands of dollars in donations to the campaign. It was no mere draft or mock-up ---it was an effective electioneering communication.

Structuring a contract so that the cost of goods and services are payable in installments is, by itself, insufficient to qualify the contract as a recurring expense. The nature of the service should be truly recurrent, i.e. the type of ongoing expense not specifically or directly associated with the production of identifiable goods and services.

In my view, the cost of developing the website for launch on March 1, 2006, is quite valuable. Effectively, the campaign received a campaign piece akin to signs or brochures on March l, 2006. The fact that websites can be modified more readily than traditional campaign communications like signs does not change the analysis. But given that the Vendor has provided continual services and upgrades to the site, this is a close question. No doubt, some ongoing services are provided by Vendor, but the initial value and use of the website brings this contract outside the "recurring services" exception. The other contract features regarding email and website maintenance may be argued to be routine and ordinary, but a bright line can be drawn between salaried staff as opposed to consultants and other persons who provide particular goods and services to a campaign, like signs, pamphlets, and websites. To do otherwise, is to invite candidates to avoid the prohibition on debt by simply structuring all contracts as "recurring."

Preliminary inquiries suggest that the market value of the current website, given the quality and complexity of its design, would be equal to a majority of the total amount payable under the Agreement. This conclusion is reflected by the early termination clause in the Agreement – even if the campaign terminates the Agreement tomorrow, the vendor will receive 75% of the total to be paid over the life of the Agreement. The campaign does note that it had over $40,000.00 in contributions by March 15, 2006. Regardless, the "recurring services" contract could not have been in place before the final Agreement was signed on March 15, 2006.

IV. Alleged Violations

A. Violations of Maximum Individual Contribution Cap and Prohibitions against Corporate Contributions

A.R.S. § 16-941(A)(1) prohibits a participating candidate from accepting contributions other than a limited number of five-dollar qualifying contributions as specified in A.R.S. § 16-946 and early contributions as specified in A.R.S. § 16-945, except in certain emergency situations inapplicable in this instance.

A.R.S. § 16-945(A) provides that a participating candidate may accept early contributions only from individuals and only during the exploratory period and the qualifying period, subject to certain limitations, including a maximum contribution of One Hundred and Twenty Dollars ($120.00) from any single contributor during an election cycle.

If Vendor provided the Website and other services without a contract, promise or agreement to receive payment from Respondent in consideration, then the provision of the Website and such services constituted an in-kind contribution to Respondent (a) in

excess of the maximum contribution limit; and (b) from a corporate donor, in violation of A.R.S. §§ 16-941(A)(1) and 16-945(A). Respondent asserts that the website was not a contribution and that a contract and payment obligation existed as of March 1. For this reason the Executive Director recommends that there is **no** reason to believe that Respondent may have violated A.R.S. §§ 16-941(A)(1) and 16-945(A).

B. Violations of Prohibitions against Debt and Expenditures in Excess of Cash on Hand Prior to Certification as a Participating Candidate

A.A.C. R2-20-104(D)(6) prohibits participating candidates from incurring debt or making expenditures in excess of the amount of cash on hand prior to qualifying for Clean Elections funding.

Respondent has acknowledged that Vendor provided the Website and other services pursuant to a contract, promise or agreement to receive payment from Respondent in consideration. If the value of the Website, emails, video production and other services exceeded the amount of Respondent's available cash on hand at any time between March 1, 2006, and March 14, 2006 then Respondent incurred debt or made an expenditure in excess of cash on hand in violation of A.A.C. R2-20-104(D)(6). Similarly, the Respondent must demonstrate it had sufficient money to pay the Vendor contract when it was signed on March 15, 2006. The Executive Director recommends that there is reason to believe that Respondent may have violated A.A.C. R2-20-104(D)(6). In order to confirm whether or not a violation has occurred, the Executive Director also recommends a field audit if a conciliation agreement is not approved by the Commission.

V. Investigation After Reason to Believe Finding

If the Commission determines by an affirmative vote of at least three (3) of its members that it has reason to believe a respondent has violated a statute or rule over which the Commission has jurisdiction, the Commission shall notify such respondent of the Commission's finding setting forth: (i) the sections of the statute or rule alleged to have been violated; (ii) the alleged factual basis supporting the finding; and (iii) an order requiring compliance within fourteen (14) days. During that period, the Respondent may provide any explanation to the commission, comply with the order, or enter into a public administrative settlement with the commission. A.R.S. § 16-957(A) & A.A.C. R2-20-208(A).

After the Commission finds reason to believe that a violation of a statute or rule over which the Commission has jurisdiction has occurred, the Commission shall conduct an investigation. A.A.C. R2-20-209(A). The Commission may authorize the Executive Director to subpoena all of the Respondent's records documenting disbursements, debts, or obligations to the present, and may authorize an audit.

Upon expiration of the fourteen (14) days, if the commission finds that the alleged violator remains out of compliance, the commission shall make a public finding to that

effect and issue an order assessing a civil penalty in accordance with A.R.S. § 16-942, unless the commission publishes findings of fact and conclusions of law expressing good cause for reducing or excusing the penalty. A.R.S. § 16-957(B).

After fourteen (14) days and upon completion of the investigation, the Executive Director will recommend whether the Commission should find probable cause to believe that a violation of a statute or rule over which the Commission has jurisdiction has occurred. A.A.C. R2-20-214(A). Upon a finding of probable cause that the alleged violator remains out of compliance, by an affirmative vote of at least three (3) of its members, the Commission may issue of an order and assess civil penalties pursuant to A.R.S. § 16-957(B). A.A.C. R2-20-217.

Dated this 22nd day of May, 2006

By: _____
Todd Lang